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## Multistate Tax Commission Allocation and Apportionment Regulations

*Adopted February 21, 1973; as revised through July 27, 2001*

(Applicable to Article IV of the Multistate Tax Compact and to the Uniform Division of Income for Tax Purposes Act.)

*The following revised regulations were adopted by the Multistate Tax Commission on February 21, 1973. Reg. IV.11.(a) and (b) were revised on July 14, 1988. Reg. IV.18.(c).4. was added on August 8, 1997. Reg. IV.2.(a).(5) was added on July 27, 2001. Special Industry Rules have been adopted and added to these Regulations (and further amended, where noted) as follows:*

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|-----------------|---|
| Reg. IV.18.(d). | Construction Contractors, July 10, 1980                                     |
| Reg. IV.18.(e). | Airlines, July 14, 1983   |
| Reg. IV.18.(f). | Railroads, July 16, 1981  |
| Reg. IV.18.(g). | Trucking Companies, July 11, 1986; amended July 27, 1989.                   |
| Reg. IV.18.(h). | Television and Radio Broadcasting, August 31, 1990; amended April 25, 1996. |
| Reg. IV.18.(i). | (Reserved)  |
| Reg. IV.18.(j). | Publishing, July 30, 1993   |

*They are subject to adoption by each member state in accordance with its own laws and procedures.*

*The numerical references of the regulations are to Article IV of the Multistate Tax Compact and its subsections.*

**Prologue.** These Regulations are intended to set forth rules concerning the application of the apportionment and allocation provisions of Article IV of the Multistate Tax Compact. The apportionment rules set forth in these Regulations are applicable to any taxpayer having business income, regardless of whether or not it has nonbusiness income, and the allocation rules set forth in these Regulations are applicable to any taxpayer having nonbusiness income, regardless of whether or not it has business income.

The only exceptions to these allocation and apportionment rules contained in these Regulations are those set forth in Regulation IV.18 pursuant to the authority of Article IV.18 of the Compact.

These Regulations are not intended to modify existing rules concerning jurisdictional standards.

••• **Reg. IV.1.(a). Business and Nonbusiness Income Defined.** Article IV.1.(a) defines "business income" as income arising from transactions and activity in the regular course of the taxpayer's trade or business and includes income from tangible and intangible property if the acquisition, management, and disposition of the property constitute integral parts of the taxpayer's regular trade or business operations. In essence, all income which arises from the conduct of trade or business operations of a taxpayer is business income. For purposes of administration of Article IV, the income of the taxpayer is business income unless clearly classifiable as nonbusiness income.

Nonbusiness income means all income other than business income.

The classification of income by the labels occasionally used, such as manufacturing income, compensation for services, sales income, interest, dividends, rents, royalties, gains, operating income, nonoperating income, etc., is of no aid in determining whether income is business or non-business income. Income of any type or class and from any source is business income if it arises from transactions and activity occurring in the regular course of a trade or business. Accordingly, the critical element in determining whether income is "business income" or "nonbusiness income" is the identification of the transactions and activity which are the elements of a particular trade or business. In general all transactions and activities of the taxpayer which are dependent upon or contribute to the operations of the taxpayer's economic enterprise as a whole constitute the taxpayer's trade or business and will be transactions and activity arising in the regular course of, and will constitute integral parts of, a trade or business. (See Regulation IV.1.(c) for more specific examples of the classification of income as business or nonbusiness income; see Regulation IV.1.(b) and IV.2.(b)(2) for further explanation of what constitutes a trade or business.)

••• **Reg. IV.1.(b). Two or More Businesses of a Single Taxpayer.** A taxpayer may have more than one "trade or business." In such cases, it is necessary to determine the business income attributable to each separate trade or business. The income of each business is then apportioned by an apportionment formula which takes into consideration the instate and outstate factors which relate to the trade or business the income of which is being apportioned.

*Example:* The taxpayer is a conglomerate with three operating divisions. One division is engaged in manufacturing aerospace items for the federal government. Another division is engaged in growing tobacco products. The third division produces and distributes motion pictures for theaters and television. Each division operates independently; there is no strong central management. Each division operates in this state as well as in other states. In this case, it is fair to conclude that the taxpayer is engaged in three separate "trades or businesses." Accordingly, the amount of business income attributable to the taxpayer's trade or business activities in this state is determined by applying an appropriate apportionment formula to the business income of each business.

**Single trade or business.** The determination of whether the activities of the taxpayer constitute a single trade or business or more than one trade or business will turn on the facts in each case. In general, the activities of the taxpayer will be considered a single business if there is evidence to indicate that the segments under consideration are integrated with, dependent upon or contribute to each other and the operations of the taxpayer as a whole. The following factors are considered to be good indicia of a single trade or business, and the presence of any of these factors creates a strong presumption that the activities of the taxpayer constitute a single trade or business:

**(1) Same type of business.** A taxpayer is generally engaged in a single trade or business when all of its activities are in the same general line. For example, a taxpayer which operates a chain of retail grocery stores will almost always be engaged in a single trade or business.

**(2) Steps in a vertical process.** A taxpayer is almost always engaged in a single trade or business when its various divisions or segments are engaged in different steps in a large, vertically structured enterprise. For example, a taxpayer which explores for and mines copper ores; concentrates, smelts and refines the copper ores; and fabricates the refined copper into consumer products is engaged in a single trade or business, regardless of the fact that the various steps in the process are operated substantially independently of each other with only general supervision from the taxpayer's executive offices.

**(3) Strong centralized management.** A taxpayer which might otherwise be considered as engaged in more than one trade or business is properly considered as engaged in one trade or business when there is a strong central management, coupled with the existence of centralized departments for such functions as financing, advertising, research, or purchasing. Thus, some conglomerates may properly be considered as engaged in only one trade or business when the central executive officers are normally involved in the operations of the various divisions and there are centralized offices which perform for the divisions the normal matters which a truly independent business would perform for itself, such as accounting, personnel, insurance, legal, purchasing, advertising, or financing.

••• **Reg. IV.1.(c). Business and Nonbusiness Income: Application of Definitions.** The following are rules and examples for determining whether particular income is business or nonbusiness income. (The examples used throughout these regulations are illustrative only and do not purport to set forth all pertinent facts.)

**(1) Rents from real and tangible personal property.** Rental income from real and tangible property is business income if the property with respect to which the rental income was received is used in the taxpayer's trade or business or incidental thereto and therefore is includable in the property factor under Regulation IV.10.

*Example (i):* The taxpayer operates a multistate car rental business. The income from car rentals is business income.

*Example (ii):* The taxpayer is engaged in the heavy construction business in which it uses equipment such as cranes, tractors, and earth-moving vehicles. The taxpayer makes short-term leases of the equipment when particular pieces of equipment are not needed on any particular project. The rental income is business income.

*Example (iii):* The taxpayer operates a multistate chain of men's clothing stores. The taxpayer purchases a five-story office building for use in connection with its trade or business. It uses the street floor as one of its retail stores and the second and third floors for its general corporate headquarters. The remaining two floors are leased to others. The rental of the two floors is incidental to the operation of the taxpayer's trade or business. The rental income is business income.

*Example (iv):* The taxpayer operates a multistate chain of grocery stores. It purchases as an investment an office building in another state with surplus funds and leases the entire building to others. The net rental income is not business income of the grocery store trade or business. Therefore, the net rental income is nonbusiness income.

*Example (v):* The taxpayer operates a multistate chain of men's clothing stores. The taxpayer invests in a 20-story office building and uses the street floor as one of its retail stores and the second floor for its general corporate headquarters. The remaining 18 floors are leased to others. The rental of the eighteen floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. The net rental income is not business income of the clothing store trade or business. Therefore, the net rental income is nonbusiness income.

*Example (vi):* The taxpayer constructed a plant for use in its multistate manufacturing business and 20 years later the plant was closed and put up for sale. The plant was rented for a temporary period from the time it was closed by the taxpayer until it was sold 18 months later. The rental income is business income and the gain on the sale of the plant is business income.

*Example (vii):* The taxpayer operates a multistate chain of grocery stores. It owned an office building which it occupied as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. The old building was rented to an investment company under a five-year lease. Upon expiration of the lease, taxpayer sold the building at a gain (or loss). The net rental income received over the lease period is nonbusiness income and the gain (or loss) on the sale of the building is nonbusiness income.

**(2) Gains or losses from sales of assets.** Gain or loss from the sale, exchange or other

disposition of real property or of tangible or intangible personal property constitutes business income if the property while owned by the taxpayer was used in the taxpayer's trade or business. However, if the property was utilized for the production of nonbusiness income or otherwise was removed from the property factor before its sale, exchange or other disposition, the gain or loss will constitute nonbusiness income. See Regulation IV.10.

*Example (i):* In conducting its multistate manufacturing business, the taxpayer systematically replaces automobiles, machines, and other equipment used in the business. The gains or losses resulting from those sales constitute business income.

*Example (ii):* The taxpayer constructed a plant for use in its multistate manufacturing business and 20 years later sold the property at a gain while it was in operation by the taxpayer. The gain is business income.

*Example (iii):* Same as (ii) except that the plant was closed and put up for sale but was not in fact sold until a buyer was found 18 months later. The gain is business income.

*Example (iv):* Same as (ii) except that the plant was rented while being held for sale. The rental income is business income and the gain on the sale of the plant is business income.

*Example (v):* The taxpayer operates a multistate chain of grocery stores. It owned an office building which it occupied as its corporate headquarters. Because of inadequate space, taxpayer acquired a new and larger building elsewhere for its corporate headquarters. The old building was rented to an unrelated investment company under a five-year lease. Upon expiration of the lease, taxpayer sold the building at a gain (or loss). The gain (or loss) on the sale is nonbusiness income and the rental income received over the lease period is nonbusiness income.

**(3) Interest.** Interest income is business income where the intangible with respect to which the interest was received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the intangible is related to or incidental to such trade or business operations.

*Example (i):* The taxpayer operates a multistate chain of department stores, selling for cash and on credit. Service charges, interest, or time-price differentials and the like are received with respect to installment sales and revolving charge accounts. These amounts are business income.

*Example (ii):* The taxpayer conducts a multistate manufacturing business. During the year the taxpayer receives a federal income tax refund and collects a judgment against a debtor of the business. Both the tax refund and the judgment bear interest. The interest income is

business income.

*Example (iii):* The taxpayer is engaged in a multistate manufacturing and wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, rain and storm damage, machinery replacement, etc. The moneys in those accounts are invested at interest. Similarly, the taxpayer temporarily invests funds intended for payment of federal, state and local tax obligations. The interest income is business income.

*Example (iv):* The taxpayer is engaged in a multistate money order and traveler's check business. In addition to the fees received in connection with the sale of the money orders and traveler's checks, the taxpayer earns interest income by the investment of the funds pending their redemption. The interest income is business income.

*Example (v):* The taxpayer is engaged in a multistate manufacturing and selling business. The taxpayer usually has working capital and extra cash totaling \$200,000 which it regularly invests in short-term interest bearing securities. The interest income is business income.

*Example (vi):* In January, the taxpayer sold all of the stock of a subsidiary for \$20,000,000. The funds are placed in an interest-bearing account pending a decision by management as to how the funds are to be utilized. The interest income is nonbusiness income.

**(4) Dividends.** Dividends are business income where the stock with respect to which the dividends are received arises out of or was acquired in the regular course of the taxpayer's trade or business operations or where the purpose of acquiring and holding the stock is related to or incidental to such trade or business operations.

*Example (i):* The taxpayer operates a multistate chain of stock brokerage houses. During the year, the taxpayer receives dividends on stock that it owns. The dividends are business income.

*Example (ii):* The taxpayer is engaged in a multistate manufacturing and wholesaling business. In connection with that business, the taxpayer maintains special accounts to cover such items as workmen's compensation claims, etc. A portion of the moneys in those accounts is invested in interest-bearing bonds. The remainder is invested in various common stocks listed on national stock exchanges. Both the interest income and any dividends are business income.

*Example (iii):* The taxpayer and several unrelated corporations own all of the stock of a corporation whose business operations consist solely of acquiring and processing materials for delivery to the corporate owners. The taxpayer acquired the stock in order to obtain a source

of supply of materials used in its manufacturing business. The dividends are business income.

*Example (iv):* The taxpayer is engaged in a multistate heavy construction business. Much of its construction work is performed for agencies of the federal government and various state governments. Under state and federal laws applicable to contracts for these agencies, a contractor must have adequate bonding capacity, as measured by the ratio of its current assets (cash and marketable securities) to current liabilities. In order to maintain an adequate bonding capacity the taxpayer holds various stocks and interest-bearing securities. Both the interest income and any dividends received are business income.

*Example (v):* The taxpayer receives dividends from the stock of its subsidiary or affiliate which acts as the marketing agency for products manufactured by the taxpayer. The dividends are business income.

*Example (vi):* The taxpayer is engaged in a multistate glass manufacturing business. It also holds a portfolio of stock and interest-bearing securities, the acquisition and holding of which are unrelated to the manufacturing business. The dividends and interest income received are nonbusiness income.

**(5) Patent and copyright royalties.** Patent and copyright royalties are business income where the patent or copyright with respect to which the royalties were received arises out of or was created in the regular course of the taxpayer's trade or business operations or where the purpose for acquiring and holding the patent or copyright is related to or incidental to such trade or business operations.

*Example (i):* The taxpayer is engaged in the multistate business of manufacturing and selling industrial chemicals. In connection with that business, the taxpayer obtained patents on certain of its products. The taxpayer licensed the production of the chemicals in foreign countries, in return for which the taxpayer receives royalties. The royalties received by the taxpayer are business income.

*Example (ii):* The taxpayer is engaged in the music publishing business and holds copyrights on numerous songs. The taxpayer acquires the assets of a smaller publishing company, including music copyrights. These acquired copyrights are thereafter used by the taxpayer in its business. Any royalties received on these copyrights are business income.

*Example (iii):* Same as example (ii), except that the acquired company also held the patent on a type of phonograph needle. The taxpayer does not manufacture or sell phonographs or phonograph equipment. Any royalties received on the patent would be nonbusiness income.

••• **Reg. IV.1.(d). Proration of Deductions.** In most cases, an allowable deduction of a taxpayer

will be applicable to only the business income arising from a particular trade or business or to a particular item of nonbusiness income. In some cases, an allowable deduction may be applicable to the business incomes of more than one trade or business and/or to several items of nonbusiness income. In such cases, the deduction shall be prorated among those trades or businesses and those items of nonbusiness income in a manner which fairly distributes the deduction among the classes of income to which it is applicable.

**(1) Year to year consistency.** In filing returns with this state, if the taxpayer departs from or modifies the manner of prorating any such deduction used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

**(2) State to state consistency.** If the returns or reports filed by a taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the application or proration of any deduction, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

••• **Reg. IV.2.(a). Definitions.**

(1) "Taxpayer" means [each state should insert the definition in Article II.3. or the definition in its own tax laws].

(2) "Apportionment" refers to the division of business income between states by the use of a formula containing apportionment factors.

(3) "Allocation" refers to the assignment of nonbusiness income to a particular state.

(4) "Business activity" refers to the transactions and activity occurring in the regular course of a particular trade or business of a taxpayer.

(5) "Gross receipts" are the gross amounts realized (the sum of money and the fair market value of other property or services received) on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest and dividends) in a transaction which produces business income, in which the income or loss is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code. Amounts realized on the sale or exchange of property are not reduced for the cost of goods sold or the basis of property sold. Gross receipts, even if business income, do not include such items as, for example:

- 1) repayment, maturity, or redemption of the principal of a loan, bond, or mutual fund or certificate of deposit or similar marketable instrument;
- 2) the principal amount received under a repurchase agreement or other transaction properly characterized as a loan;



- 3) proceeds from issuance of the taxpayer's own stock or from sale of treasury stock;
- 4) damages and other amounts received as the result of litigation;
- 5) property acquired by an agent on behalf of another;
- 6) tax refunds and other tax benefit recoveries;
- 7) pension reversions;
- 8) contributions to capital (except for sales of securities by securities dealers);
- 9) income from forgiveness of indebtedness; or
- 10) amounts realized from exchanges of inventory that are not recognized by the Internal Revenue Code.

Exclusion of an item from the definition of "gross receipts" is not determinative of its character as business or nonbusiness income. Nothing in this definition shall be construed to modify, impair or supersede any provision of Section IV.18.

••• **Reg. IV.2.(b)(1). Application of Article IV: Apportionment.** If the business activity in respect to any trade or business of a taxpayer occurs both within and without this state, and if by reason of such business activity the taxpayer is taxable in another state, the portion of the net income (or net loss) arising from such trade or business which is derived from sources within this state shall be determined by apportionment in accordance with Article IV.9. to IV.17.

••• **Reg. IV.2.(b)(2). Application of Article IV: Combined Report.** If a particular trade or business is carried on by a taxpayer and one or more affiliated corporations, nothing in Article IV or in these regulations shall preclude the use of a "combined report" whereby the entire business income of such trade or business is apportioned in accordance with Article IV.9. to IV.17.

••• **Reg. IV.2.(b)(3). Application of Article IV: Allocation.** Any taxpayer subject to the taxing jurisdiction of this state shall allocate all of its nonbusiness income or loss within or without this state in accordance with Article IV.4. to IV.8.

••• **Reg. IV.2.(c). Consistency and Uniformity in Reporting.**

(1) **Year to year consistency.** In filing returns with this state, if the taxpayer departs from or modifies the manner in which income has been classified as business income or nonbusiness income in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

(2) **State to state consistency.** If the returns or reports filed by a taxpayer for all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the classification of income as business or nonbusiness income, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

••• **Reg. IV.3.(a). Taxable in Another State: In General.** Under Article IV.2. the taxpayer is subject to the allocation and apportionment provisions of Article IV if it has income from business activity that is taxable both within and without this state. A taxpayer's income from business activity is taxable without this state if the taxpayer, by reason of such business activity (i.e., the transactions and activity occurring in the regular course of a particular trade or business), is taxable in another state within the meaning of Article IV.3.

**(1) Applicable tests.** A taxpayer is taxable within another state if it meets either one of two tests: (1) By reason of business activity in another state, the taxpayer is subject to one of the types of taxes specified in Article IV.3.(1), namely: A net income tax, a franchise tax measured by net income, a franchise tax for the privilege of doing business, or a corporate stock tax; or (2) By reason of such business activity, another state has jurisdiction to subject the taxpayer to a net income tax, regardless of whether or not the state imposes such a tax on the taxpayer.

**(2) Producing nonbusiness income.** A taxpayer is not taxable in another state with respect to a particular trade or business merely because the taxpayer conducts activities in that other state pertaining to the production of nonbusiness income or business activities relating to a separate trade or business.

••• **Reg. IV.3.(b).Taxable in Another State: When a Corporation Is "Subject to" a Tax under Article IV.3.(1).**

(1) A taxpayer is "subject to" one of the taxes specified in Article IV.3.(1) if it carries on business activities in a state and the state imposes such a tax thereon. Any taxpayer which asserts that it is subject to one of the taxes specified in Article IV.3.(1) in another state shall furnish to the [tax administrator] of this state upon his/her request evidence to support that assertion. The [tax administrator] of this state may request that such evidence include proof that the taxpayer has filed the requisite tax return in the other state and has paid any taxes imposed under the law of the other state; the taxpayer's failure to produce such proof may be taken into account in determining whether the taxpayer in fact is subject to one of the taxes specified in Article IV.3.(1) in the other state.

**Voluntary tax payment.** If the taxpayer voluntarily files and pays one or more of such taxes when not required to do so by the laws of that state or pays a minimal fee for qualification, organization or for the privilege of doing business in that state, but

(A) does not actually engage in business activity in that state, or

(B) does actually engage in some business activity not sufficient for nexus and the minimum tax bears no relationship to the taxpayer's business activity within such state, the taxpayer is not "subject to" one of the taxes specified within the meaning of Article IV.3.(1).

*Example:* State A has a corporation franchise tax measured by net income for the privilege of doing business in that state. Corporation X files a return and pays the \$50 minimum tax, although it carries on no business activity in State A. Corporation X is not taxable in State A.

(2) The concept of taxability in another state is based upon the premise that every state in which the taxpayer is engaged in business activity may impose an income tax even though every state does not do so. In states which do not, other types of taxes may be imposed as a substitute for an income tax. Therefore, only those taxes enumerated in Article IV.3.(1) which may be considered as basically revenue raising rather than regulatory measures shall be considered in determining whether the taxpayer is "subject to" one of the taxes specified in Article IV.3.(1) in another state.

*Example (i):* State A requires all nonresident corporations which qualify or register in State A to pay to the Secretary of State an annual license fee or tax for the privilege of doing business in the state regardless of whether the privilege is in fact exercised. The amount paid is determined according to the total authorized capital stock of the corporation; the rates are progressively higher by bracketed amounts. The statute sets a minimum fee of \$50 and a maximum fee of \$500. Failure to pay the tax bars a corporation from utilizing the state courts for enforcement of its rights. State A also imposes a corporation income tax. Nonresident Corporation X is qualified in State A and pays the required fee to the Secretary of State but does not carry on any business activity in State A (although it may utilize the courts of State A). Corporation X is not "taxable" in State A.

*Example (ii):* Same facts as Example (i) except that Corporation X is subject to and pays the corporation income tax. Payment is prima facie evidence that Corporation X is "subject to" the net income tax of State A and is "taxable" in State A.

*Example (iii):* State B requires all nonresident corporations qualified or registered in State B to pay to the Secretary of State an annual permit fee or tax for doing business in the state. The base of the fee or tax is the sum of (1) outstanding capital stock, and (2) surplus and undivided profits. The fee or tax base attributable to State B is determined by a three factor apportionment formula. Nonresident Corporation X which operates a plant in State B, pays the required fee or tax to the Secretary of State. Corporation X is "taxable" in State B.

*Example (iv):* State A has a corporation franchise tax measured by net income for the privilege of doing business in that state. Corporation X files a return based upon its business activity in the state but the amount of computed liability is less than the minimum tax. Corporation X pays the minimum tax. Corporation X is subject to State A's corporation franchise tax.

••• **Reg. IV.3.(c). Taxable in Another State: When a State Has Jurisdiction to Subject a Taxpayer to a Net Income Tax.** The second test, that of Article IV.3.(2), applies if the taxpayer's business activity is sufficient to give the state jurisdiction to impose a net income tax by reason of such business activity under the Constitution and statutes of the United States. Jurisdiction to tax is not present where the state is prohibited from imposing the tax by reason of the provisions of Public Law 86-272, 15 U.S.C.A. §§ 381-385. In the case of any "state" as defined in Article IV.1.(h), other than a state of the United States or political subdivision thereof, the determination of whether the "state" has jurisdiction to subject the taxpayer to a net income tax shall be made as though the jurisdictional standards applicable to a state of the United States applied in that "state." If jurisdiction is otherwise present, that "state" is not considered as being without jurisdiction by reason of the provisions of a treaty between that "state" and the United States.

*Example:* Corporation X is actively engaged in manufacturing farm equipment in State A and in foreign country B. Both State A and foreign country B impose a net income tax but foreign country B exempts corporations engaged in manufacturing farm equipment. Corporation X is subject to the jurisdiction of State A and foreign country B.

••• **Reg. IV.9. Apportionment Formula.** All business income of each trade or business of the taxpayer shall be apportioned to this state by use of the apportionment formula set forth in Article IV.9. The elements of the apportionment formula are the property factor (see Regulation IV.10.), the payroll factor (see Regulation IV.13.) and the sales factor (see Regulation IV.15.) of the trade or business of the taxpayer.

••• **Reg. IV.10.(a). Property Factor: In General.** The property factor of the apportionment formula for each trade or business of the taxpayer shall include all real and tangible personal property owned or rented by the taxpayer and used during the tax period in the regular course of the trade or business. The term "real and tangible personal property" includes land, buildings, machinery, stocks of goods, equipment, and other real and tangible personal property but does not include coin or currency. Property used in connection with the production of nonbusiness income shall be excluded from the property factor. Property used both in the regular course of the taxpayer's trade or business and in the production of nonbusiness income shall be included in the factor only to the extent that the property is used in the regular course of the taxpayer's trade or business. The method of determining that portion of the value to be included in the factor will depend upon the facts of each case. The property factor shall include the average value of property includable in the factor. See Regulation IV.12.

••• **Reg. IV.10.(b). Property Factor: Property Used for the Production of Business Income.** Property shall be included in the property factor if it is actually used or is available for or capable of being used during the tax period in the regular course of the trade or business of the taxpayer. Property held as reserves or standby facilities or property held as a reserve source of materials shall be included in the factor. For example, a plant temporarily idle or raw material reserves not currently being processed are includable in the factor. Property or equipment under construction during the tax period

(except inventorable goods in process) shall be excluded from the factor until such property is actually used in the regular course of the trade or business of the taxpayer. If the property is partially used in the regular course of the trade or business of the taxpayer while under construction, the value of the property to the extent used shall be included in the property factor. Property used in the regular course of the trade or business of the taxpayer shall remain in the property factor until its permanent withdrawal is established by an identifiable event such as its conversion to the production of nonbusiness income, its sale, or the lapse of an extended period of time (normally, five years) during which the property is held for sale.

*Example (i):* Taxpayer closed its manufacturing plant in State X and held the property for sale. The property remained vacant until its sale one year later. The value of the manufacturing plant is included in the property factor until the plant is sold.

*Example (ii):* Same as above except that the property was rented until the plant was sold. The plant is included in the property factor until the plant is sold.

*Example (iii):* Taxpayer closed its manufacturing plant and leased the building under a five-year lease. The plant is included in the property factor until the commencement of the lease.

*Example (iv):* The taxpayer operates a chain of retail grocery stores. Taxpayer closed Store A, which was then remodeled into three small retail stores such as a dress shop, dry cleaning, and barber shop, which were leased to unrelated parties. The property is removed from the property factor on the date on which the remodeling of Store A commenced.

### ••• **Reg. IV.10.(c). Property Factor: Consistency in Reporting.**

**(1) Year to year consistency.** In filing returns with this state, if the taxpayer departs from or modifies the manner of valuing property or of excluding property from or including property in the property factor used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

**(2) State to state consistency.** If the returns or reports filed by the taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the valuation of property and in the exclusion of property from or the inclusion of property in the property factor, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

••• **Reg. IV.10.(d). Property Factor: Numerator.** The numerator of the property factor shall include the average value of the real and tangible personal property owned or rented by the taxpayer and used in this state during the tax period in the regular course of the trade or business of the taxpayer. Property in transit between locations of the taxpayer to which it belongs shall be considered to be at the

destination for purposes of the property factor. Property in transit between a buyer and seller which is included by a taxpayer in the denominator of its property factor in accordance with its regular accounting practices shall be included in the numerator according to the state of destination. The value of mobile or movable property such as construction equipment, trucks or leased electronic equipment which are located within and without this state during the tax period shall be determined for purposes of the numerator of the factor on the basis of total time within the state during the tax period. An automobile assigned to a traveling employee shall be included in the numerator of the factor of the state to which the employee's compensation is assigned under the payroll factor or in the numerator of the state in which the automobile is licensed.

••• **Reg. IV.11.(a). Property Factor: Valuation of Owned Property.**

(1) Property owned by the taxpayer shall be valued at its original cost. As a general rule, "original cost" is deemed to be the basis of the property for federal income tax purposes (prior to any federal adjustments) at the time of acquisition by the taxpayer and adjusted by subsequent capital additions or improvements thereto and partial disposition thereof, by reason of sale, exchange, abandonment, etc. However, capitalized intangible drilling and development costs shall be included in the property factor whether or not they have been expensed for either federal or state tax purposes. [This last sentence was added on July 14, 1988.]

*Example (i):* The taxpayer acquired a factory building in this state at a cost of \$500,000 and, 18 months later, expended \$100,000 for major remodeling of the building. Taxpayer files its return for the current taxable year on the calendar-year basis. Depreciation deduction in the amount of \$22,000 was claimed with respect to the building on the return for the current taxable year. The value of the building includable in the numerator and denominator of the property factor is \$600,000; the depreciation deduction is not taken into account in determining the value of the building for purposes of the factor.

*Example (ii):* During the current taxable year, Corporation X merges into Corporation Y in a tax-free reorganization under the Internal Revenue Code. At the time of the merger, Corporation X owns a factory which X built five years earlier at a cost of \$1,000,000. X has been depreciating the factory at the rate of two percent per year, and its basis in X's hands at the time of the merger is \$900,000. Since the property is acquired by Y in a transaction in which, under the Internal Revenue Code, its basis in Y's hands is the same as its basis in X's hands, Y includes the property in Y's property factor at X's original cost, without adjustment for depreciation, i.e. \$1,000,000.

*Example (iii):* Corporation Y acquires the assets of Corporation X in a liquidation by which Y is entitled to use its stock cost as the basis of the X assets under Section 334(b)(2) of the 1954 Internal Revenue Code (i.e. stock possessing 80 percent control is purchased and liquidated within two years). Under these circumstances, Y's cost of the assets is the purchase

price of the X stock, prorated over the X assets.

If the original cost of property is unascertainable, the property is included in the factor at its fair market value as of the date of acquisition by the taxpayer.

(2) Inventory of stock of goods shall be included in the factor in accordance with the valuation method used for federal income tax purposes.

(3) Property acquired by gift or inheritance shall be included in the factor at its basis for determining depreciation for federal income tax purposes.

••• **Reg. IV.11.(b). Property Factor: Valuation of Rented Property.**

**(1) Multiplier and subrentals.** Property rented by the taxpayer is valued at eight times its net annual rental rate. The net annual rental rate for any item of rented property is the annual rental rate paid by the taxpayer for the property less the aggregate annual subrental rates paid by subtenants of the taxpayer. (See Regulation IV.18.(a) for special rules when the use of such net annual rental rate produces a negative or clearly inaccurate value or when property is used by the taxpayer at no charge or is rented at a nominal rental rate.)

Subrents are not deducted when they constitute business income because the property which produces the subrents is used in the regular course of a trade or business of the taxpayer when it is producing such income. Accordingly there is no reduction in its value.

*Example (i):* The taxpayer receives subrents from a bakery concession in a food market operated by the taxpayer. Since the subrents are business income, they are not deducted from rent paid by the taxpayer for the food market.

*Example (ii):* The taxpayer rents a 5-story office building primarily for use in its multistate business, uses three floors for its offices and subleases two floors to various other businesses and persons such as professional people and shops. The rental of the two floors is incidental to the operation of the taxpayer's trade or business. Since the subrents are business income, they are not deducted from the rent paid by the taxpayer.

*Example (iii):* The taxpayer rents a 20-story office building and uses the lower two stories for its general corporation headquarters. The remaining 18 floors are subleased to others. The rental of the eighteen floors is not incidental to but rather is separate from the operation of the taxpayer's trade or business. Since the subrents are nonbusiness income they are to be deducted from the rent paid by the taxpayer.

(2) "Annual rental rate" is the amount paid as rental for property for a 12-month period (i.e.,

the amount of the annual rent). Where property is rented for less than a 12-month period, the rent paid for the actual period of rental shall constitute the "annual rental rate" for the tax period. However, where a taxpayer has rented property for a term of 12 or more months and the current tax period covers a period of less than 12 months (due, for example, to a reorganization or change of accounting period), the rent paid for the short tax period shall be annualized. If the rental term is for less than 12 months, the rent shall not be annualized beyond its term. Rent shall not be annualized because of the uncertain duration when the rental term is on a month-to-month basis.

*Example (i):* Taxpayer A, which ordinarily files its returns based on a calendar year, is merged into Taxpayer B on April 30. The net rent paid under a lease with 5 years remaining is \$2,500 a month. The rent for the tax period January 1 to April 30 is \$10,000. After the rent is annualized the net rent is \$30,000 (\$2,500 x 12).

*Example (ii):* Same facts as in Example (i) except that the lease would have terminated on August 31. In this case, the annualized rent is \$20,000 (\$2,500 x 8).

**(3) "Annual rent"** is the actual sum of money or other consideration payable, directly or indirectly, by the taxpayer or for its benefit for the use of the property and includes:

(A) Any amount payable for the use of real or tangible personal property, or any part thereof, whether designated as a fixed sum of money or as a percentage of sales, profits or otherwise.

*Example:* A taxpayer, pursuant to the terms of a lease, pays a lessor \$1,000 per month as a base rental and at the end of the year pays the lessor one percent of its gross sales of \$400,000. The annual rent is \$16,000 (\$12,000 plus one percent of \$400,000 or \$4,000).

(B) Any amount payable as additional rent or in lieu of rents, such as interest, taxes, insurance, repairs or any other items which are required to be paid by the terms of the lease or other arrangement, not including amounts paid as service charges, such as utilities, janitor services, etc. If a payment includes rent and other charges unsegregated, the amount of rent shall be determined by consideration of the relative values of the rent and other items.

*Example (i):* A taxpayer, pursuant to the terms of a lease, pays the lessor \$12,000 a year rent plus taxes in the amount of \$2,000 and interest on a mortgage in the amount of \$1,000. The annual rent is \$15,000.

*Example (ii):* A taxpayer stores part of its inventory in a public warehouse. The total charge for the year was \$1,000 of which \$700 was for the use of storage space and \$300 for inventory insurance, handling and shipping charges, and C.O.D. collections. The annual rent is \$700.



**(4) Exclusions.** "Annual rent" does not include:

(A) Incidental day-to-day expenses such as hotel or motel accommodations, daily rental of automobiles, etc.; and

(B) Royalties based on extraction of natural resources, whether represented by delivery or purchase. For this purpose, a royalty includes any consideration conveyed or credited to a holder of an interest in property which constitutes a sharing of current or future production of natural resources from such property, irrespective of the method of payment or how such consideration may be characterized, whether as a royalty, advance royalty, rental or otherwise. [This provision was added on July 14, 1988.]

**(5) Leasehold improvements** shall, for the purposes of the property factor, be treated as property owned by the taxpayer regardless of whether the taxpayer is entitled to remove the improvements or the improvements revert to the lessor upon expiration of the lease. Hence, the original cost of leasehold improvements shall be included in the factor.

••• **Reg. IV.12. Property Factor: Averaging Property Values.** As a general rule, the average value of property owned by the taxpayer shall be determined by averaging the values at the beginning and ending of the tax period. However, the [tax administrator] may require or allow averaging by monthly values if that method of averaging is required to properly reflect the average value of the taxpayer's property for the tax period.

Averaging by monthly values will generally be applied if substantial fluctuations in the values of the property exist during the tax period or if property is acquired after the beginning of the tax period or disposed of before the end of the tax period.

*Example:* The monthly value of the taxpayer's property was as follows:

January	\$2,000	July	\$15,000
February	2,000	August	17,000
March	3,000	September	23,000
April	3,500	October	25,000
May	4,500	November	13,000
June	<u>10,000</u>	December	<u>2,000</u>
	\$25,000		\$95,000
		Total	<u>\$120,000</u>

The average value of the taxpayer's property includable in the property factor for the

income year is determined as follows:

$$\frac{\$120,000}{12} = \$10,000$$

Averaging with respect to rented property is achieved automatically by the method of determining the net annual rental rate of such property as set forth in Reg. IV.11.(b).

••• **Reg. IV.13.(a). Payroll Factor: In General.**

(1) The payroll factor of the apportionment formula for each trade or business of the taxpayer shall include the total amount paid by the taxpayer in the regular course of its trade or business for compensation during the tax period.

(2) The total amount "paid" to employees is determined upon the basis of the taxpayer's accounting method. If the taxpayer has adopted the accrual method of accounting, all compensation properly accrued shall be deemed to have been paid. Notwithstanding the taxpayer's method of accounting, compensation paid to employees may, at the election of the taxpayer, be included in the payroll factor by use of the cash method if the taxpayer is required to report such compensation under that method for unemployment compensation purposes.

The compensation of any employee on account of activities which are connected with the production of nonbusiness income shall be excluded from the factor.

*Example (i):* The taxpayer uses some of its employees in the construction of a storage building which, upon completion, is used in the regular course of the taxpayer's trade or business. The wages paid to those employees are treated as a capital expenditure by the taxpayer. The amount of those wages is included in the payroll factor.

*Example (ii):* The taxpayer owns various securities which it holds as an investment separate and apart from its trade or business. The management of the taxpayer's investment portfolio is the only duty of Mr. X, an employee. The salary paid to Mr. X is excluded from the payroll factor.

(3) The term "compensation" means wages, salaries, commissions and any other form of remuneration paid to employees for personal services. Payments made to an independent contractor or any other person not properly classifiable as an employee are excluded. Only amounts paid directly to employees are included in the payroll factor. Amounts considered paid directly include the value of board, rent, housing, lodging, and other benefits or services furnished to employees by the taxpayer in return for personal services provided that such amounts constitute income to the recipient under the federal Internal Revenue Code. In the case of employees not subject to the federal Internal Revenue

Code, e.g., those employed in foreign countries, the determination of whether such benefits or services would constitute income to the employees shall be made as though such employees were subject to the federal Internal Revenue Code.

(4) The term "employee" means (A) any officer of a corporation, or (B) any individual who, under the usual common-law rules applicable in determining the employer-employee relationship, has the status of an employee. Generally, a person will be considered to be an employee if he is included by the taxpayer as an employee for purposes of the payroll taxes imposed by the Federal Insurance Contributions Act; except that, since certain individuals are included within the term "employees" in the Federal Insurance Contributions Act who would not be employees under the usual common-law rules, it may be established that a person who is included as an employee for purposes of the Federal Insurance Contributions Act is not an employee for purposes of this regulation.

**(5) Year to year consistency.** In filing returns with this state, if the taxpayer departs from or modifies the treatment of compensation paid used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

**(6) State to state consistency.** If the returns or reports filed by the taxpayer with all states to which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the treatment of compensation paid, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

•• **Reg. IV.13.(b). Payroll Factor: Denominator.** The denominator of the payroll factor is the total compensation paid everywhere during the tax period. Accordingly, compensation paid to employees whose services are performed entirely in a state where the taxpayer is immune from taxation, for example, by Public Law 86-272, is included in the denominator of the payroll factor.

*Example:* A taxpayer has employees in its state of legal domicile (State A) and is taxable in State B. In addition the taxpayer has other employees whose services are performed entirely in State C where the taxpayer is immune from taxation under the provisions of Public Law 86-272. As to these latter employees, the compensation will be assigned to State C where their services are performed (i.e., included in the denominator but not the numerator of the payroll factor) even though the taxpayer is not taxable in State C.

•• **Reg. IV.13.(c). Payroll Factor: Numerator.** The numerator of the payroll factor is the total amount paid in this state during the tax period by the taxpayer for compensation. The tests in Article IV.14. to be applied in determining whether compensation is paid in this state are derived from the Model Unemployment Compensation Act. Accordingly, if compensation paid to employees is included in the payroll factor by use of the cash method of accounting or if the taxpayer is required to report such compensation under that method for unemployment compensation purposes, it shall be presumed that the total wages reported by the taxpayer to this state for unemployment compensation purposes

constitute compensation paid in this state except for compensation excluded under Regulation IV.13.(a). to IV.14. The presumption may be overcome by satisfactory evidence that an employee's compensation is not properly reportable to this state for unemployment compensation purposes.

••• **Reg. IV.14. Payroll Factor: Compensation Paid in This State.** Compensation is paid in this state if any one of the following tests, applied consecutively, are met:

(1) The employee's service is performed entirely within the state.

(2) The employee's service is performed both within and without the state, but the service performed without the state is incidental to the employee's service within the state. The word "incidental" means any service which is temporary or transitory in nature, or which is rendered in connection with an isolated transaction.

(3) If the employee's services are performed both within and without this state, the employee's compensation will be attributed to this state:

(A) if the employee's base of operations is in this state; or

(B) if there is no base of operations in any state in which some part of the service is performed, but the place from which the service is directed or controlled is in this state; or

(C) if the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed but the employee's residence is in this state.

The term "place from which the service is directed or controlled" refers to the place from which the power to direct or control is exercised by the taxpayer.

The term "base of operations" is the place of more or less permanent nature from which the employee starts his work and to which he customarily returns in order to receive instructions from the taxpayer or communications from his customers or other persons or to replenish stock or other materials, repair equipment, or perform any other functions necessary to the exercise of his trade or profession at some other point or points.

••• **Reg. IV.15.(a). Sales Factor: In General.**

(1) Article IV.1.(g) defines the term "sales" to mean all gross receipts of the taxpayer not allocated under paragraphs (5) through (8) of Article IV. Thus, for the purposes of the sales factor of the apportionment formula for each trade or business of the taxpayer, the term "sales" means all gross receipts derived by the taxpayer from transactions and activity in the regular course of the trade or business. The following are rules for determining "sales" in various situations:

(A) In the case of a taxpayer engaged in manufacturing and selling or purchasing and reselling goods or products, "sales" includes all gross receipts from the sales of such goods or products (or other property of a kind which would properly be included in the inventory of the taxpayer if on hand at the close of the tax period) held by the taxpayer primarily for sale to customers in the ordinary course of its trade or business. Gross receipts for this purpose means gross sales less returns and allowances, and includes all interest income, service charges, carrying charges, or time-price differential charges incidental to such sales. Federal and state excise taxes (including sales taxes) shall be included as part of such receipts if the taxes are passed on to the buyer or included as part of the selling price of the product.

(B) In the case of cost plus fixed fee contracts, such as the operation of a government-owned plant for a fee, "sales" includes the entire reimbursed cost plus the fee.

(C) In the case of a taxpayer engaged in providing services, such as the operation of an advertising agency or the performance of equipment service contracts or research and development contracts, "sales" includes the gross receipts from the performance of such services, including fees, commissions, and similar items.

(D) In the case of a taxpayer engaged in renting real or tangible property, "sales" includes the gross receipts from the rental, lease, or licensing the use of the property.

(E) In the case of a taxpayer engaged in the sale, assignment, or licensing of intangible personal property such as patents and copyrights, "sales" includes the gross receipts therefrom.

(F) If a taxpayer derives receipts from the sale of equipment used in its business, those receipts constitute sales. For example, a truck express company owns a fleet of trucks and sells its trucks under a regular replacement program. The gross receipts from the sales of the trucks are included in the sales factor.

**(2) Exceptions.** In some cases certain gross receipts should be disregarded in determining the sales factor in order that the apportionment formula will operate fairly to apportion to this state the income of the taxpayer's trade or business. See Regulation IV.18.(c).

**(3) Year to year consistency.** In filing returns with this state, if the taxpayer departs from or modifies the basis for excluding or including gross receipts in the sales factor used in returns for prior years, the taxpayer shall disclose in the return for the current year the nature and extent of the modification.

**(4) State to state consistency.** If the returns or reports filed by the taxpayer with all states to

which the taxpayer reports under Article IV of this Compact or the Uniform Division of Income for Tax Purposes Act are not uniform in the inclusion or exclusion of gross receipts, the taxpayer shall disclose in its return to this state the nature and extent of the variance.

•• **Reg. IV.15.(b). Sales Factor: Denominator.** The denominator of the sales factor shall include the total gross receipts derived by the taxpayer from transactions and activity in the regular course of its trade or business, except receipts excluded under Regulation IV.18.(c).

•• **Reg. IV.15.(c). Sales Factor: Numerator.** The numerator of the sales factor shall include gross receipts attributable to this state and derived by the taxpayer from transactions and activity in the regular course of its trade or business. All interest income, service charges, carrying charges, or time-price differential charges incidental to such gross receipts shall be included regardless of (1) the place where the accounting records are maintained or (2) the location of the contract or other evidence of indebtedness.

•• **Reg. IV.16.(a). Sales Factor: Sales of Tangible Personal Property in This State.**

(1) Gross receipts from sales of tangible personal property (except sales to the United States Government; see Regulation IV.16.(b)) are in this state:

(A) if the property is delivered or shipped to a purchaser within this state regardless of the f.o.b. point or other conditions of sale; or

(B) if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state and the taxpayer is not taxable in the state of the purchaser.

(2) Property shall be deemed to be delivered or shipped to a purchaser within this state if the recipient is located in this state, even though the property is ordered from outside this state.

*Example:* The taxpayer, with inventory in State A, sold \$100,000 of its products to a purchaser having branch stores in several states, including this state. The order for the purchase was placed by the purchaser's central purchasing department located in State B. \$25,000 of the purchase order was shipped directly to purchaser's branch store in this state. The branch store in this state is the purchaser within this state with respect to \$25,000 of the taxpayer's sales.

(3) Property is delivered or shipped to a purchaser within this state if the shipment terminates in this state, even though the property is subsequently transferred by the purchaser to another state.

*Example:* The taxpayer makes a sale to a purchaser who maintains a central warehouse in this state at which all merchandise purchases are received. The purchaser reships

the goods to its branch stores in other states for sale. All of the taxpayer's products shipped to the purchaser's warehouse in this state constitute property delivered or shipped to a purchaser within this state.

(4) The term "purchaser within this state" shall include the ultimate recipient of the property if the taxpayer in this state, at the designation of the purchaser, delivers to or has the property shipped to the ultimate recipient within this state.

*Example:* A taxpayer in this state sold merchandise to a purchaser in State A. Taxpayer directed the manufacturer or supplier of the merchandise in State B to ship the merchandise to the purchaser's customer in this state pursuant to purchaser's instructions. The sale by the taxpayer is in this state.

(5) When property being shipped by a seller from the state of origin to a consignee in another state is diverted while en route to a purchaser in this state, the sales are in this state.

*Example:* The taxpayer, a produce grower in State A, begins shipment of perishable produce to the purchaser's place of business in State B. While en route, the produce is diverted to the purchaser's place of business in this state in which state the taxpayer is subject to tax. The sale by the taxpayer is attributed to this state.

(6) If the taxpayer is not taxable in the state of the purchaser, the sale is attributed to this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state.

*Example:* The taxpayer has its head office and factory in State A. It maintains a branch office and inventory in this state. Taxpayer's only activity in State B is the solicitation of orders by a resident salesman. All orders by the State B salesman are sent to the branch office in this state for approval and are filled by shipment from the inventory in this state. Since the taxpayer is immune under Public Law 86-272 from tax in State B, all sales of merchandise to purchasers in State B are attributed to this state, the state from which the merchandise was shipped.

(7) If a taxpayer whose salesman operates from an office located in this state makes a sale to a purchaser in another state in which the taxpayer is not taxable and the property is shipped directly by a third party to the purchaser, the following rules apply:

(A) If the taxpayer is taxable in the state from which the third party ships the property, then the sale is in that state.

(B) If the taxpayer is not taxable in the state from which the property is shipped, then the sale is in this state.

*Example:* The taxpayer in this state sold merchandise to a purchaser in State A. Taxpayer is not taxable in State A. Upon direction of the taxpayer, the merchandise was shipped directly to the purchaser by the manufacturer in State B. If the taxpayer is taxable in State B, the sale is in State B. If the taxpayer is not taxable in State B, the sale is in this state.

••• **Reg. IV.16.(b). Sales Factor: Sales of Tangible Personal Property to the United States Government in This State.** Gross receipts from sales of tangible personal property to the United States Government are in this state if the property is shipped from an office, store, warehouse, factory, or other place of storage in this state. For the purposes of this regulation, only sales for which the United States Government makes direct payment to the seller pursuant to the terms of a contract constitute sales to the United States Government. Thus, as a general rule, sales by a subcontractor to the prime contractor, the party to the contract with the United States Government, do not constitute sales to the United States Government.

*Example (i):* A taxpayer contracts with General Services Administration to deliver X number of trucks which were paid for by the United States Government. The sale is a sale to the United States Government.

*Example (ii):* The taxpayer, as a subcontractor to a prime contractor with the National Aeronautics and Space Administration, contracts to build a component of a rocket for \$1,000,000. The sale by the subcontractor to the prime contractor is not a sale to the United States Government.

••• **Reg. IV.17. Sales Factor: Sales Other Than Sales of Tangible Personal Property in This State**

**(1) In general.** Article IV.17. provides for the inclusion in the numerator of the sales factor of gross receipts from transactions other than sales of tangible personal property (including transactions with the United States Government); under this section, gross receipts are attributed to this state if the income producing activity which gave rise to the receipts is performed wholly within this state. Also, gross receipts are attributed to this state if, with respect to a particular item of income, the income producing activity is performed within and without this state but the greater proportion of the income producing activity is performed in this state, based on costs of performance.

**(2) Income producing activity: defined.** The term "income producing activity" applies to each separate item of income and means the transactions and activity directly engaged in by the taxpayer in the regular course of its trade or business for the ultimate purpose of obtaining gains or profit. Such activity does not include transactions and activities performed on behalf of a taxpayer, such as those conducted on its behalf by an independent contractor. Accordingly, income producing activity includes but is not limited to the following:



(A) The rendering of personal services by employees or the utilization of tangible and intangible property by the taxpayer in performing a service.

(B) The sale, rental, leasing, licensing or other use of real property.

(C) The rental, leasing, licensing or other use of tangible personal property.

(D) The sale, licensing or other use of intangible personal property.

The mere holding of intangible personal property is not, of itself, an income producing activity.

**(3) Costs of performance: defined.** The term "costs of performance" means direct costs determined in a manner consistent with generally accepted accounting principles and in accordance with accepted conditions or practices in the trade or business of the taxpayer.

**(4) Application.**

**(A) In general.** Receipts (other than from sales of tangible personal property) in respect to a particular income producing activity are in this state if:

(a) the income producing activity is performed wholly within this state; or

(b) the income producing activity is performed both in and outside this state and a greater proportion of the income producing activity is performed in this state than in any other state, based on costs of performance.

**(B) Special rules.** The following are special rules for determining when receipts from the income producing activities described below are in this state:

(a) Gross receipts from the sale, lease, rental or licensing of real property are in this state if the real property is located in this state.

(b) Gross receipts from the rental, lease, or licensing of tangible personal property are in this state if the property is located in this state. The rental, lease, licensing or other use of tangible personal property in this state is a separate income producing activity from the rental, lease, licensing or other use of the same property while located in another state; consequently, if property is within and without this state during the rental, lease or licensing period, gross receipts attributable to this state shall be measured by the ratio which the time the property was physically present or was used in this state bears to the total time or use of the property everywhere during that period.

*Example:* Taxpayer is the owner of 10 railroad cars. During the year, the total of the

days during which each railroad car was present in this state was 50 days. The receipts attributable to the use of each of the railroad cars in this state are a separate item of income and shall be determined as follows:

$$\frac{(10 \times 50) = 500}{3650} \times \text{Total Receipts} = \text{Receipts Attributable to this State}$$

(c) Gross receipts for the performance of personal services are attributable to this state to the extent that such services are performed in this state. If services relating to a single item of income are performed partly within and partly without this state, the gross receipts from the performance of such services shall be attributable to this state only if the greater proportion of the services was performed in the state, based on costs of performance. Usually, where services are performed partly within and partly without this state, the services performed in each state will constitute a separate income producing activity; in such cases, the gross receipts from the performance of services attributable to this state shall be measured by the ratio which the time spent in performing the services in this state bears to the total time spent in performing the services everywhere. Time spent in performing services includes the amount of time expended in the performance of a contract or other obligation which gives rise to such gross receipts. Personal service not directly connected with the performance of the contract or other obligation, as for example time expended in negotiating the contract, is excluded from the computations.

*Example (i):* Taxpayer, a road show, gave theatrical performances at various locations in State X and in this state during the tax period. All gross receipts from performances given in this state are attributed to this state.

*Example (ii):* The taxpayer, a public opinion survey corporation, conducted a poll by means of its employees in State X and in this state for the sum of \$9,000. The project required 600 man-hours to obtain the basic data and prepare the survey report. Two hundred of the 600 man hours were expended in this state. The receipts attributable to this state are \$3,000.

$$\frac{200}{600} \times \$9,000 = \$3,000$$

••• **Reg. IV.18.(a). Special Rules: In General.** Article IV.18. provides that if the allocation and apportionment provisions of Article IV do not fairly represent the extent of the taxpayer's business activity in this state, the taxpayer may petition for or the tax administrator may require, in respect to all or any part of the taxpayer's business activity, if reasonable:

- (1) separate accounting;
- (2) the exclusion of any one or more of the factors;

(3) the inclusion of one or more additional factors which will fairly represent the taxpayer's business activity in this state; or

(4) the employment of any other method to effectuate an equitable allocation and apportionment of the taxpayer's income.

Article IV.18. permits a departure from the allocation and apportionment provisions of Article IV only in limited and specific cases. Article IV.18. may be invoked only in specific cases where unusual fact situations (which ordinarily will be unique and non recurring) produce incongruous results under the apportionment and allocation provisions contained in Article IV.

In the case of certain industries such as air transportation, rail transportation, ship transportation, trucking, television, radio, motion pictures, various types of professional athletics, and so forth, the foregoing regulations in respect to the apportionment formula do not set forth appropriate procedures for determining the apportionment factors. Nothing in Article IV.18. or in this Regulation IV.18. shall preclude [the tax administrator] from establishing appropriate procedures under Article IV.10. to 17. for determining the apportionment factors for each such industry, but such procedures shall be applied uniformly.

••• **Reg. IV.18.(b). Special Rules: Property Factor.** The following special rules are established in respect to the property factor of the apportionment formula:

(1) If the subrents taken into account in determining the net annual rental rate under Regulation IV.11.(b) produce a negative or clearly inaccurate value for any item of property, another method which will properly reflect the value of rented property may be required by the [tax administrator] or requested by the taxpayer.

In no case, however, shall the value be less than an amount which bears the same ratio to the annual rental rate paid by the taxpayer for the property as the fair market value of that portion of the property used by the taxpayer bears to the total fair market value of the rented property.

*Example:* The taxpayer rents a 10-story building at an annual rental rate of \$1,000,000. Taxpayer occupies two stories and sublets eight stories for \$1,000,000 a year. The net annual rental rate of the taxpayer must not be less than two-tenths of the taxpayer's annual rental rate for the entire year, or \$200,000.

(2) If property owned by others is used by the taxpayer at no charge or rented by the taxpayer for a nominal rate, the net annual rental rate for the property shall be determined on the basis of a reasonable market rental rate for the property.

••• **Reg. IV.18.(c). Special Rules: Sales Factor.** The following special rules are established in

respect to the sales factor of the apportionment formula:

(1) Where substantial amounts of gross receipts arise from an incidental or occasional sale of a fixed asset used in the regular course of the taxpayer's trade or business, those gross receipts shall be excluded from the sales factor. For example, gross receipts from the sale of a factory or plant will be excluded.

(2) Insubstantial amounts of gross receipts arising from incidental or occasional transactions or activities may be excluded from the sales factor unless their exclusion would materially affect the amount of income apportioned to this state. For example, the taxpayer ordinarily may include in or exclude from the sales factor gross receipts from transactions such as the sale of office furniture, business automobiles, etc.

(3) Where the income producing activity in respect to business income from intangible personal property can be readily identified, the income is included in the denominator of the sales factor and, if the income producing activity occurs in this state, in the numerator of the sales factor as well. For example, usually the income producing activity can be readily identified in respect to interest income received on deferred payments on sales of tangible property (Regulation IV.15.(a)(1)(A)) and income from the sale, licensing or other use of intangible personal property (Regulation IV.17.(2)(D)).

Where business income from intangible property cannot readily be attributed to any particular income producing activity of the taxpayer, the income cannot be assigned to the numerator of the sales factor for any state and shall be excluded from the denominator of the sales factor. For example, where business income in the form of dividends received on stock, royalties received on patents or copyrights, or interest received on bonds, debentures or government securities results from the mere holding of the intangible personal property by the taxpayer, the dividends and interest shall be excluded from the denominator of the sales factor.

(4) (A) Where gains and losses on the sale of liquid assets are not excluded from the sales factor by other provisions under Reg.IV.18.(c)., such gains or losses shall be treated as provided in this subsection. This subsection does not provide rules relating to the treatment of other receipts produced from holding or managing such assets. If a taxpayer holds liquid assets in connection with one or more treasury functions of the taxpayer, and the liquid assets produce business income when sold, exchanged or otherwise disposed, the overall net gain from those transactions for each treasury function for the tax period is included in the sales factor. For purposes of this subsection, each treasury function will be considered separately.

(B) For purposes of this subsection, a liquid asset is an asset (other than functional currency or funds held in bank accounts) held to provide a relatively immediate source of funds to satisfy the liquidity needs of the trade or business. Liquid assets include foreign currency (and trading positions therein) other than functional currency used in the regular course of the taxpayer's trade or business; marketable

instruments (including stocks, bonds, debentures, options, warrants, futures contracts, etc.); and mutual funds which hold such liquid assets. An instrument is considered marketable if it is traded in an established stock or securities market and is regularly quoted by brokers or dealers in making a market. Stock in a corporation which is unitary with the taxpayer, or which has a substantial business relationship with the taxpayer is not considered marketable stock.

(C) For purposes of this subsection, a treasury function is the pooling and management of liquid assets for the purpose of satisfying the cash flow needs of the trade or business, such as providing liquidity for a taxpayer's business cycle, providing a reserve for business contingencies, business acquisitions, etc. A taxpayer principally engaged in the trade or business of purchasing and selling instruments or other items included in the definition of liquid assets set forth herein is not performing a treasury function with respect to income so produced.

(D) Overall net gain refers to the total net gain from all transactions incurred at each treasury function for the entire tax period, not the net gain from a specific transaction.

(E) Examples.

*Example (i).* A taxpayer manufactures various gift items. Because of seasonal variations, the taxpayer must keep liquid assets available for later inventory acquisitions. Because the manufacturer wants to obtain a return on available funds, the manufacturer acquires liquid assets, which are held and managed in State A. The net gain resulting from all gains and losses on the sale of the liquid assets for the tax year will be reflected in the denominator of the sales factor and in the numerator of State A.

*Example (ii).* A stockbroker acts as a dealer or trader for its own account in its ordinary course of business. Some of the instruments sold are liquid assets. This subsection does not operate to classify those sales as attributable to a treasury function.